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Client Alert: Employers Should Begin Preparing for New Overtime Rules

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See the [most recent update](#).

On March 13, 2014, President Obama directed the Department of Labor to update its overtime regulations under the Fair Labor Standards Act (“FLSA”), and the DOL issued its draft regulations in July 2015. After considerable delay (a welcome development from the standpoint of employers) during the comment and revision period, the DOL appears prepared to release the final rules shortly, likely by July 1, 2016, with employers required to be in compliance 60 days later. Although there are a few months remaining until the new regulations go into effect, employers should begin making preparations now for what will be a significant shift in overtime policy under the FLSA.

Existing Law under the FLSA

The FLSA, first enacted in 1938 and amended several times since then, provides for a federal minimum wage, a standard 40-hour workweek, and pay at time-and-a-half for all overtime hours, among other requirements. However, the law also includes several exemptions from its provisions for certain classes of workers, the most common of which are the so-called, “white collar” exemptions. These exemptions encompass three subcategories of workers: (1) executive (think supervisory/management employees); (2) administrative (think HR professionals, insurance adjusters, and other employees exercising substantial discretion as to important matters); and (3) professional (think doctors, lawyers, accountants, teachers, and other learned professionals with advanced degrees). Unlike non-exempt employees, none of the aforementioned classes of employees is entitled to premium pay for overtime hours.

To qualify for one of these “white collar” exemptions, an employee must satisfy a two-part test. First, the employee’s actual job duties must be of a particular nature for each of the exemptions. To qualify as an exempt executive, for example, an employee must have the primary duty of management of the business, must customarily and regularly supervise at least two other full-time employees, and must have authority to hire and fire (or significant input into such decisions). Second, the employee must meet the “salary basis” test, which requires that the employee be paid a set salary of no less than \$455 per week (\$23,600 annually). Other than some narrowly construed, permissible deductions, a salaried, exempt employee must receive at least his or her full salary during any week in which any work is performed, whether it be 1 hour or 100 hours. Non-exempt employees, in contrast, are generally (but not always) paid hourly, must be paid only for the hours actually worked, and must receive premium pay for all hours over 40 in a workweek.

What is Changing and What is Not (We Think)

By far the most significant change to the FLSA under the new overtime regulations is a sizeable increase in the required salary basis. Although employers will need to await publication of the final rules to know the exact amount, it is likely to be at or near the level set by the proposed rules last July of \$970 per week (\$50,440 annually). Obviously, this is a substantial increase of more than double the current salary basis. While it is possible that the final rules set a lower amount, employers should expect a sizeable increase in any event. Another significant change expected in the new rules is that the salary basis will be tied to a national wage standard which will be adjusted annually. In the proposed rules, this amount was set at the 40th percentile for the weekly wages of all full-time, salaried employees, and the salary amount will be adjusted every year to equal this level. That means that employers must continually monitor their exempt employees' wages and provide pay increases as necessary to stay at or above what will be a continually shifting threshold. The final change expected in the new rules, which affects only a small number of employees, is an increase in the salary basis to qualify for the "highly compensated employee" exemption. This exemption applies to employees who meet some, but not all of the required duties for an exemption and are paid at least \$100,000 annually. Like the normal salary basis, the salary basis for highly compensated employees will also be tied to a national standard—likely the 90th percentile of weekly wages for all full-time, salaried employees (currently \$122,148)—and must be adjusted annually. In a nutshell, depending on the salary amounts currently paid to exempt employees, employers may have to pay substantially more than is currently required under the FLSA to qualify for an overtime exemption.

Although these new rules will certainly present a challenge for many employers—particularly those in industries such as hospitality and retail where relatively low wages are common among managers, shift supervisors, and similar positions—employers can take solace in the fact that it appears a significant area will stay the same: the duties tests. During the initial drafting and comment phase for the new rules, there were substantial indications that the DOL would tighten up the duties tests and make it even more difficult for employees to qualify as exempt. One possibility would have been a bright-line rule that an exempt executive employee must spend at least 50% of his or her time engaged in management duties, which would have virtually destroyed the exemption as it relates to, for example, retail store managers, who typically spend a significant portion of their time engaging in tasks such as stocking shelves, helping customers, and working the cash register in addition to their management responsibilities. Employers can breathe a sigh of relief that the duties tests do not appear to be changing, at least for now.

What Employers Need to Do to Prepare

As it pertains to employees who are currently exempt but are not paid enough to qualify under the increased salary basis, there are really only two options for employers under the new overtime regulations: increase their employees' salaries at or above the new threshold, or treat such employees as non-exempt. The first option will come at an increased cost, and the DOL estimates that as many as 50% of currently exempt employees will become non-exempt due to the cost of compliance with the new rules. Choosing this option will also amount to a regulation-backed guarantee to provide an exempt employee with an annual raise to ensure that he or she stays above the shifting (and likely increasing) threshold. The second option requires that an employer track the employee's hours and pay him or her the overtime premium for all hours over 40 in a workweek. Whether or not this results in an increase in compensation will depend upon how many hours the employee works.

We recommend that employers begin working now to analyze their work force to determine how they will manage the new overtime rules. Employers should begin by analyzing their workforce and identifying those employees most likely to be affected. For employees who make far less than the proposed new salary basis,

the decision is likely an easy one—it will almost certainly be more beneficial to treat such employees as non-exempt than to more or less double their current salary. For exempt employees who are closer to the new salary basis, employers should begin requiring them to track their hours on an interim basis, which will allow the employer to accurately determine the relative costs to the company of reclassifying versus raising the salary of a particular employee. Many employers have no more than a general idea as to how many hours their exempt employees actually work—this is not surprising since it previously had not mattered. During the interim timekeeping period, exempt employees should be required not only to clock in and out at the beginning and end of a shift, but also for lunch breaks lasting at least 30 minutes, during which they are completely relieved from duty. Employers will want to tighten up their break procedures and ensure that “working” lunches taken at the employees’ desks are prohibited. Employers should also require exempt employees to track time spent outside of work engaged in work tasks—checking emails, answering phone calls, and similar tasks. All of this work is compensable for non-exempt employees and contributes to the 40-hour-per-week overtime threshold. This timekeeping need not utilize fancy machinery or software—a notepad and pen will work just fine.

The employer should closely monitor its exempt employees’ hours over a period of several weeks and determine the best course of action. For employees who are already near the proposed salary basis and work a high number of hours, the math will likely dictate that increasing their salaries makes the most financial sense. For those who work close to 40 hours and rarely work overtime, it may be more sensible to treat them as non-exempt and simply pay overtime when applicable. Paying non-exempt employees a salary is also an option. Paying a salary would allow the employer to pay the employee only half-time for overtime hours rather than the full time-and-one-half premium. Keep in mind, however, that paying salary to non-exempt employees is a double-edged sword, in that there may be workweeks where the employee works substantially less than 40 hours but is still entitled to the full weekly salary. Other measures, such as mandatory lunch breaks, hours reductions, and policies prohibiting working from home, may also help control the hours of non-exempt employees and avoid overtime situations. Another possible option is to divide job duties among multiple employees, which may involve new hires, in order to more evenly distribute the workload. There are a myriad of options to ensure compliance with the new overtime rules, but it is imperative that all employers begin the necessary analysis so that the appropriate decisions can be made.

One final consideration is employee morale, and employers should begin developing appropriate messaging to address these changes. Many employees may not appreciate the perceived loss in status which accompanies a switch from a salaried to an hourly role. The key message to employees should be that these changes should not result in a decrease in pay. Rather, the goal is to maintain pay at roughly the same level, which may take a bit of adjustment during the first few months to ensure that the hourly wage being paid and the amount of overtime being worked match their current salary. A silver lining to these changes is that they also give employers some cover to reclassify employees whose duties perhaps already made their exemption suspect—now employers have a built in reason to reclassify such employees as non-exempt without raising red flags. Developing consistent, positive messaging well before the new rules take effect will go a long way towards maintaining a happy and productive workforce.

Clearly, the impending changes to the FLSA’s overtime rules represent a significant challenge to employers. However, with careful thought and advance planning, employers can navigate this new landscape with minimal cost and disruption. If you have any questions regarding the new overtime rules, or any other general employment compliance concerns, please contact Daniel R. Strader at dstrader@shumaker.com or (941) 364-2735 .